

**BEFORE THE DEPARTMENT OF COMMERCE AND INSURANCE
FOR THE STATE OF TENNESSEE**

IN THE MATTER OF:

**THE FARMERS MUTUAL FIRE INSURANCE
COMPANY OF SEVIER COUNTY**

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No.: 05-010

ORDER ADOPTING EXAMINATION REPORT WITH DIRECTIVES

Pursuant to Tenn. Code Ann. §§ 56-22-101, *et seq.* and 56-1-401, *et seq.*, the Insurance Division of the State of Tennessee Department of Commerce and Insurance (hereinafter referred to as the "Division") has examined certain affairs of The Farmers Mutual Fire Insurance Company of Sevier County (hereinafter also referred to as the "Company"), a county mutual fire insurance company domiciled in the State of Tennessee. As a result of an examination conducted as of the 31st day of December, 2003, the examiner-in-charge filed with the Division, on the 23rd day of November, 2004, a verified, written report on examination, and a copy of that report has been sent to The Farmers Mutual Fire Insurance Company of Sevier County. (The Report of Examination of The Farmers Mutual Fire Insurance Company of Sevier County is attached hereto and marked as Exhibit A). The Division received written rebuttal to said examination report from the company on December 29, 2004. (A true and exact copy of the company's written rebuttal is attached hereto and marked as Exhibit B).

Pursuant to Tenn. Code Ann. § 56-22-132, said examination report regarding the affairs of The Farmers Mutual Fire Insurance Company of Sevier County, filed with the Insurance Division of the State of Tennessee Department of Commerce and Insurance on the 23rd day of November, 2004, is hereby **ADOPTED** as filed with the following **DIRECTIVES**:

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Dept. Of Commerce & Insurance
Company Examinations

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Dept. Of Commerce & Insurance
Financial Services & Regulatory Section

1. The Company is **DIRECTED** to comply with Tenn. Code Ann. § 56-7-102 by completely disclosing all policy terms on its policy forms for each and every kind or type of coverage offered, as well as the premium obligation of the policyholder for all coverages accepted by the policyholder.
2. The Company is **DIRECTED** to comply with Tenn. Code Ann. § 56-1-405 by refraining from listing as admitted assets those assets that are not available for the payment of policyholder losses.

The company shall comply with the directives contained in this order within thirty (30) days of its entry.

The adoption of this examination report shall not preclude the Department from imposing sanctions against The Farmers Mutual Fire Insurance Company of Sevier County for potential violations of the Tennessee Insurance Law which may be revealed in the examination report, it being the intent of this Order Adopting Examination Report With Directives merely to adopt the examination report filed by the examiner-in-charge.

It is so **ORDERED**.

ENTERED this the 31st day of January, 2005.

Paula A. Flowers

Paula A. Flowers, Commissioner
Department of Commerce and Insurance
State of Tennessee

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Dept. Of Commerce & Insurance
Company Examinations

PREPARED FOR ENTRY:

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Eric J. Stansell (BPR# 021707)

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Tennessee Department of Commerce and Insurance

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Nashville, Tennessee 37243

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing Order Adopting Examination Report as Filed has been messenger mailed to Larry C. Knight, Jr., Assistant Commissioner for Insurance, Department of Commerce and Insurance, and Don Spann, Chief Examiner, Department of Commerce and Insurance, and mailed, first class, postage prepaid, to The Farmers Mutual Fire Insurance Company of Sevier County, 144 West Main Street, Sevierville, Tennessee 37862, on this the 1st day of February, 2005.

Eric J. Stansell

Eric J. Stansell

Certifying Attorney

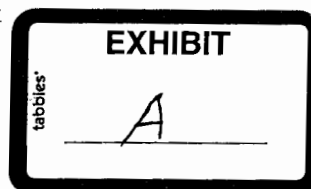
Report of Examination
of
The Farmers Mutual Fire Insurance Company of Sevier County
Sevierville, Tennessee

Bill Delozier, Secretary
144 West Main Street
Sevierville, TN 37862

Examination made as of: December 31, 2003

Examiner in Charge: James T. Pearce, Examiner III

Examination commenced: May 17, 2004



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Dept. Of Commerce & Insurance
Corporate Examinations

Date of Report: November 23, 2004

Examined as of: December 31, 2003

Last Examination as of: December 31, 1998

Commissioner Paula A. Flowers
Department of Commerce and Insurance
State of Tennessee
Nashville, Tennessee 37243

Commissioner,

Pursuant to your instructions, I have made an examination and submit the following report of the conditions and affairs of the

Farmers Mutual Fire Insurance Company of Sevier County

Sevierville, Tennessee

Officers

Title	Name	Address	Term Expires
President	Lillard Allen	Sevierville, TN	January 2004
Vice President	James E. Gibson	Sevierville, TN	January 2004
Secretary & Treasurer	Bill Delozier	Seymour, TN	January 2004

Directors:

Name	Address	Term Expires
Lillard Allen, President	Sevierville, TN	January 2006
James E. Gibson, Vice President	Sevierville, TN	January 2005
Bill Delozier, Secretary & Treasurer	Seymour, TN	January 2005
Dayton Douglas	Sevierville, TN	January 2006
Glenn Ellis	Sevierville, TN	January 2006
Warren Hurst	Sevierville, TN	January 2005
William Howard Montgomery	Pigeon Forge, TN	January 2005
Dwight R. Wade	Sevierville, TN	January 2006

Directors (cont.):

Name	Address	Term Expires
Curtis Wells	Sevierville, TN	January 2007

Compensation of officers, directors, appraisers, adjusters, et al:

The president received \$6,000 in 2003 or \$500 per month, the secretary / treasurer received \$20,000.00 in 2003. The directors received \$200 per called meeting. The officers received \$100 per committee meeting. In 2003 the Company's bookkeeper received \$37,014.25 and the Company's office clerk received \$2,748.00. The Company paid \$700 to have the office cleaned in 2003.

Agents are paid 50% of the first year's premium for a new policy and the policies are issued on a continuous basis until canceled. Agents are paid 50% of the first year's premium for an increase in coverage on an existing policy. As of May 11, 2001, agents were not paid an in-house commission. The Company's agents must conduct an on-site inspection in order to receive a commission on the first year's premium.

The Company had five (5) licensed agents and they are as follows: Bill Delozier, Virginia Newman, Lillard Allen, James Gibson and Curtis Wells.

The Company's claim adjustments are mainly performed by Bill Delozier (Director / Officer / Agent) and James Gibson (Director / Officer / Agent).

The Company paid \$75 for each loss adjustment made by Bill Delozier and James Gibson.

The Company paid their agents \$10 for each dwelling inspected and \$5 for each out building inspected for an existing policy.

Report of changes in the Constitution or By-Laws, policy forms, or other agreements during the period covered by this examination.

In 2001 the Company adopted the use of the Basic Policy Form, Farm Coverage Form and the Broad Theft Coverage Form published by the American Association of Insurance Services. The Company also issued amendments to dwelling coverage concerning trees, vacancy, unoccupancy, minimum earned premium and debris removal to the policy form. Finally, the Company issued a privacy policy for its policyholders.

In 1999 the Company raised the deductible for all claims (except for theft) from \$100 to \$250. In 2001 the Company set the deductible for all claims, including theft (for the first time), at \$250. The \$250 deductible amount for all claims was still in place as of year-end 2003.

In 2001 the Company started allowing the policyholder to pay on a yearly, semi-annual or quarterly basis. Policyholders were charged a \$5.00 fee for each semi-annual or quarterly payment.

Report of changes in the Constitution or By-Laws, policy forms, or other agreements during the period covered by this examination (continued).

During 2001, the Company began participating in the liability program with Farmers Mutual of Tennessee (Knoxville) by marketing the Farmers Mutual policy to the policyholders of the Company. The Company acted in the capacity of an agency and remitted the premiums to Farmers Mutual on an account current basis.

For all policies written by the Company which insured a dwelling for \$80,000 or more, a \$100,000 liability policy issued by Farmers Mutual and a \$10,000 theft policy issued by the Company was included as a benefit to the policyholder. The premium for the said liability and theft policy was paid and absorbed by the Company at no expense to the insured.

For the aforementioned policies the Company's declaration page listed "Broad Theft Coverage" and "Farmers Mutual of Tennessee Liability" coverage for the insured without an amount for premiums.

However, Tenn. Code Ann. § 56-22-101(a) does not permit the Company to insure for liability exposure nor does it allow the Company to act as an agent on behalf of Farmers Mutual of Tennessee (Knoxville) for the issuance of a liability policy.

The Company at year-end 2003 had 102 policies that insured a dwelling for \$80,000 or more and provided, at no cost to the policyholder, a \$100,000 liability policy and a \$10,000 theft policy. The total amount of premium for these liability and theft policies that was not collected by the Company was \$8,126.00.

In 2001 the Company started offering a construction policy (builder's risk) according to the value of the house.

In 2002 the Company started reassessing all of its insured risks. The Company's agents in some cases recommended an increase in coverage to its policyholders. The policyholders at their discretion could elect for a higher rate of coverage and a corresponding increase in the premium assessment amount. The Company's agents in some cases recommended cancellation of coverage on risks that had sharply deteriorated and risks that were unoccupied for several years.

On September 13, 2002 the Company's Board approved a variable rate schedule for all risks but as of December 31, 2003 the Company had not yet fully developed and implemented a variable rate schedule for all risks.

The Company's premium rate for dwellings was \$5.00 per thousand up to \$100,000 and \$3.00 per thousand over \$100,000(except for rental property) as of December 31, 2003.

The Company's single-wide mobile home rate was \$15.00 per thousand as of December 31, 2003. The Company's double wide mobile home rate was \$6.00 per thousand (up to \$50,000 of coverage) and the Company's double wide mobile home rate was \$5.00 per thousand for double-wide mobile homes insured for more than \$50,000 as of December 31, 2003.

Report of changes in the Constitution or By-Laws, policy forms, or other agreements during the period covered by this examination (continued).

Barn, outbuildings, livestock and hay were insured at \$6.00 per thousand.

In 2004 the Company was in the process of implementing a new premium rate schedule.

If copies have not been filed with the Department of Commerce and Insurance, are they filed with the work papers of this report?

The changes to the rate schedule were not filed with the Department and are included in the Company's policy form. The Company's policy forms that were in use as of year-end 2003 were included in the examination work papers. Copies of the minutes to the Board of Directors meeting at which the by-laws, policy forms or agreement were enacted or changed are included in the work papers of this examination report.

Report on reinsurance assumed and / or ceded.

Type: Combination Per Risk / Aggregate Excess of Loss
Reinsurer: Farmers Mutual of Tennessee
Term: Continuous contract, effective January 1, 2002.
Coverage: Section I – Property Risk Excess of Loss: The reinsurer shall not be liable for any loss hereunder until the Company's ultimate net loss, each risk, each loss occurrence, exceeds \$50,000 and then the reinsurer shall be liable for 100% of the Company's ultimate net loss, each risk, each loss occurrence, in excess of \$50,000 but the reinsurers liability shall not exceed \$150,000 each risk, each occurrence.

Section II – Aggregate Excess of Loss: The reinsurer shall not be liable for any loss hereunder until the Company's ultimate net loss, in the aggregate for each calendar year, exceeds the greater of (a) 85% of the Company's gross written premium or (b) \$400,000 and then the reinsurer shall be liable for 100% of the Company's ultimate net loss in excess of that amount, but the reinsurers liability, for each calendar year, shall not exceed 100% of the lesser of (a) 85% of the Company's gross written premiums or (b) \$500,000.

Type: Second Aggregate Excess of Loss
Reinsurer: Farmers Mutual of Tennessee
Term: Continuous contract, effective January 1, 2002.
Coverage: The reinsurer shall not be liable for any loss hereunder until the ultimate net loss, in the aggregate for each calendar year, exceeds the greater of 85% of the Company's gross written premium or \$400,000, plus the lesser of 85% of gross written premium or \$500,000 and then the reinsurer shall be liable for 100% of the Company's ultimate net loss of that amount.

Report on reinsurance assumed and / or ceded (continued).

The Company did not experience any losses in excess of the Company's specific retention per policy of \$50,000 in 2002 and 2003. Furthermore, the Company did not experience any losses in excess of the Company's aggregate retention level of \$458,924 in 2002 and 2003 respectively. Consequently, the Company did not receive any settlements from its reinsurer Farmers Mutual of Tennessee for 2002 and 2003 losses.

Appraisal and classification of risks taken.

Policies are typically written for the full value of the property insured subject to policy limits of \$50,000 per risk. The agent performs the appraisal on the property prior to the issuance of a policy during the application process.

The Company had five (5) licensed agents and they are as follows: Bill Delozier, Virginia Newman, Lillard Allen, James Gibson and Curtis Wells.

The Company in order to be compliant with Tenn. Code Ann. § 56-22-130 "Person responsible for accepting or rejecting insurance shall be compensated otherwise than by commissions" as of May 11, 2001 had each agent submit all new policies to be approved by an Officer / Director (other than themselves) as follows:

Ms. Virginia Newman (Bookkeeper / Agent) has her underwriting approved by the Company's Secretary / Treasurer, Bill Delozier (Director / Officer / Agent).

Bill Delozier (Director / Officer / Agent) has his underwriting approved by the Company's President Lillard Allen (Director / Officer).

The Company's Vice President, James Gibson (Director / Officer / Agent) and Curtis Wells (Director / Agent) have their underwriting approved by Bill Delozier (Director / Officer / Agent).

Property insured by the Company includes dwellings and contents, church buildings, farm buildings and contents, hay in barns, farm machinery, cattle and some commercial type property (same rate as dwellings).

Annual rate of assessment per \$1,000.00 for period covered:

The Company's premium rate for dwellings was \$ 5.00 per thousand up to \$100,000 and \$3.00 per thousand over \$100,000(except for rental property) as of December 31, 2003.

The Company's single-wide mobile home rate was \$15.00 per thousand as of December 31, 2003. The Company's double wide mobile home rate was \$6.00 per thousand (up to \$50,000 of coverage) and the Company's double wide mobile home rate was \$5.00 per thousand for double-wide mobile homes insured for more than \$50,000 as of December 31, 2003.

Barns, outbuildings, livestock and hay were insured at \$6.00 per thousand.

Annual rate of assessment per \$1,000.00 for period covered (continued):

For any dwelling over \$80,000 the policyholder was automatically given liability and theft coverage at no cost.

See the examination work papers for the Company's rate schedule effective each year from 1999 through 2003 for all new or renewal policies written.

Rate of membership, policy and initial fees charged.

As of December 31, 2003, the Company had \$111,163,291 of total insurance in force.

In 2001 the Company started allowing the policyholder to pay on a yearly, semi-annual or quarterly basis. The Company charged a \$5.00 fee for each semi-annual or quarterly payment.

Date of last assessment.

The Company makes advance assessments of its members on the policy renewal date.

Amount delinquent.

There were no delinquencies. The Company cancels policies if assessments are not paid within forty five (45) days after the end of the policy period.

Did that assessment provide for all losses, expenses and other liabilities, including borrowed money?

No. In 2003 the Company received \$539,911 in net premium assessments (net of reinsurance premiums and return assessments). In 2003 the Company disbursed \$588,318 or \$48,407 more than net premium assessments. However, the Company received \$55,994 interest income (savings and certificates of deposit) and policy fees (\$5.00 charge for the semi-annual payment of premium). The Company borrowed \$230,000 in 2003 which was not reflected on the Income Section of the Company's 2003 Annual Statement due to the Annual Statement being presented on an accrual basis.

Amount of money borrowed since date of last assessment.

The Company borrowed \$230,000 in 2003 which was not reflected on the Income Section of the Company's 2003 Annual Statement due to the Annual Statement being presented on an accrual basis. The Company borrowed \$50,000 in January 2003 and repaid \$50,000 principal and \$165.75 interest in February 2003. The Disbursement Section of the 2003 Annual Statement did not show the repayment of the \$50,000 principal amount borrowed due to the use of accrual accounting methods in the presentation of the Annual Statement.

The Company borrowed \$30,000 on December 2, 2003 from Sevier County Bank and repaid \$30,000 principal and \$379.72 interest on February 24, 2004. The Company borrowed \$50,000 on December 10, 2003 from Sevier County Bank and repaid \$50,000 principal and \$527.39 interest on February 18, 2004. The Company borrowed \$100,000 on December 29, 2003 from Citizens National Bank and repaid \$100,000 principal and the related interest on March 10, 2004.

The Company's Minutes of the meeting of the Board of Directors in 2003 and the loan agreements reflected the money borrowed by the Company was for the payment of losses.

Exhibit of Risks

	<u>Amount</u>
1. Gross Amount In-Force, December 31, 2002	\$89,461,141
2. New Business Written in 2003	22,775,700
3. Business Renewed in 2003	<u>6,869,325</u>
4. Total	* \$119,106,166
5. Deduct those expired and marked off as terminated	<u>(7,942,875)</u>
6. Gross Amount In-force, December 31, 2003	\$111,163,291
7. Amount Re-insured	<u>(\$12,363,375)</u>
8. Net Amount In force, December 31, 2003	\$98,799,916

The Company as of December 31, 2003 had approximately 2,196 policyholders.

Financial Statement**Income**

Gross Assessments	\$573,724.00
Deduct : Reinsurance(includes liability insurance)	(28,917.00)
Deduct : Return Assessments	<u>(4,896.00)</u>
Net Assessments	\$539,911.00
Interest Income and Policy Fees	55,994.00
Total Income	\$595,905.00
Ledger Assets, December 31, 2002	<u>\$1,290,481.00</u>
Total Income and Balance	<u>\$1,886,386.00</u>

Financial Statement

Disbursements

Gross amount paid policyholders for losses	\$381,819.00
Deduct : Reinsurance	<u>(NONE)</u>
Net amount paid policyholders for losses	\$381,819.00
Expenses of adjustment and settlement of losses	5,660.00
Commission or brokerage, including membership fees	69,185.00
Salaries and compensation of officers, directors, & employees	61,396.00
Advertising, Printing and Stationery	1,400.00
Postage, telegrams, telephones and express	3,071.00
Legal Expenses	NONE
Furniture and Fixtures	NONE
Insurance department licenses and fees (premium tax)	8,413.00
All other licenses, fees and taxes	9,841.00
Charitable Contributions	305.00
Depreciation	4,829.00
Health Insurance	9,931.00
Insurance on the Company	1,191.00
Professional Expense (Accounting)	4,050.00
Repairs and Maintenance	80.00
Bank Charges	20.00
Penalties and Fines Expense	473.00
Dues and Subscriptions Expense	389.00
Office Expense	9,702.00
Utilities	2,814.00
Meals and Entertainment	1,072.00
Travel	740.00
Interest Repaid on Borrowed Money	514.00
Payroll Taxes	11,423.00
Total disbursement	<u>\$588,318.00</u>
Balance	<u>\$1,298,068.00</u>

Balance Sheet

There follows a statement of assets and liabilities as of December 31, 2003 together with a reconciliation of surplus, as established by this examination.

Assets

	<u>Admitted Assets Per Company</u>	<u>Non-Admitted Assets Per Examination</u>	<u>Net-Admitted Assets Per Examination</u>
Book Value of Real Estate	\$84,127		\$84,127
Cash in Company's Office	200		200
Cash in Banks (Business Checking)	6,932		6,932
Savings Account	11,069		11,069
Certificates of Deposit	1,560,061		1,560,061
Interest Receivable	7,379		7,379
Premiums Receivable	18,074		18,074
Prepaid Insurance	1,260	*1,260	0
Prepaid Premium Tax	<u>8,016</u>	<u>*8,016</u>	<u>0</u>
TOTAL ASSETS	<u>\$ 1,697,118</u>	<u>*\$ 9,276</u>	<u>\$ 1,687,842</u>

* See the Prepaid Expenses Not-Admitted heading (below) on page 13 of this Examination Report.

Liabilities, Surplus and Other Funds

	<u>Liabilities and Surplus Per Company</u>	<u>Examination Adjustments</u>	<u>Liabilities and Surplus Per Examination</u>
Gross Losses Adjusted and Unpaid	\$15,420		\$15,420
Interest Due or Accrued on Borrowed Money	330		330
Salaries, Notes, Expenses, Bills, Accounts, Fees Due	3,492		3,492
Unearned Premium	201,056		201,056
Due and to Become Due For Borrowed Money	<u>180,000</u>		<u>180,000</u>
TOTAL LIABILITIES	\$400,298		\$400,298
 Surplus as Regards Policyholders	 <u>\$1,296,821</u>	 <u>*\$9,276</u>	 <u>\$1,287,544</u>
TOTALS	<u>\$ 1,697,118</u>	<u>*\$ 9,276</u>	<u>\$ 1,687,842</u>

Assets

Schedule of Bank Deposits:

<u>Name of Bank</u>	<u>Amount on Bank Statement</u>	<u>Amount of O/S Checks</u>	<u>Adj. Items</u>	<u>Balance</u>
Sevier County Bank, Commercial Checking	\$76,471.36	(\$72,248.17)	**\$2,709.00	\$6,932.19
Suntrust Bank, Advantage Rate Money Market	\$11,063.80	\$-0-	\$-0-	\$11,063.80

** The Company had a \$2,826.50 deposit-in-transit that was not reflected on the December 2003, Sevier County Bank Statement but was recorded on the Company's records as of December 31, 2003. Also, the Company received a \$117.50 premium payment that did not clear the bank. The Company accounted for this premium payment as accounts receivable less than 90 days past due and included this \$117.50 amount in the \$18,074 "Assessments Levied and Uncollected" total noted under the Assets Section – IV in the 2003 Annual Statement. The net total of the two (2) aforementioned adjustments was \$2,709.00.

Schedule and description of all other assets, including real estate, mortgage loans, bonds, etc., and interest or rents due or accrued thereon:

Certificates of Deposit :

Sevier County Bank of Sevierville, TN	\$250,000.00
Suntrust Bank of Sevierville, TN	\$100,000.00
First Tennessee Bank of Sevierville, TN	\$100,000.00
Tennessee State Bank of Sevierville, TN	\$100,000.00
Tennessee State Bank of Sevierville, TN	\$50,000.00
Tennessee State Bank of Sevierville, TN	\$50,000.00
Tennessee State Bank of Sevierville, TN	\$100,000.00
Citizens National Bank of Sevierville, TN	\$150,000.00
Citizens National Bank of Sevierville, TN	\$60,000.00
Home Federal Bank of Sevierville, TN	\$100,060.66
Mountain National Bank of Sevierville, TN	\$100,000.00
Mountain National Bank of Sevierville, TN	\$100,000.00
Mountain National Bank of Sevierville, TN	\$100,000.00
B B & T of Sevierville, TN	\$50,000.00
B B & T of Sevierville, TN	\$50,000.00
AmSouth Bank of Sevierville, TN	<u>\$100,000.00</u>
Total Certificates of Deposit	\$1,560,060.66

Assets pledged or hypothecated:

The Company at year-end 2003 had an \$80,000 outstanding loan balance with Sevier County Bank. The Company pledged its \$250,000 certificate of deposit # 39782 held at Sevier County Bank as collateral.

The Company at year-end 2003 had a \$100,000 outstanding loan balance with Citizens National Bank. The Company pledged its \$150,000 certificate of deposit # 56536 held at Citizens National Bank as collateral.

Comments on claims, borrowed money and other liabilities:

The Company borrowed \$230,000 in 2003 which was not reflected on the Income Section of the Company's 2003 Annual Statement due to the Annual Statement being presented on an accrual basis. The Company borrowed \$50,000 in January 2003 and repaid \$50,000 principal and \$165.75 interest in February 2003. The Disbursement Section of the 2003 Annual Statement did not show the repayment of the \$50,000 principal amount borrowed due to the use of accrual accounting methods in the presentation of the Annual Statement.

Comments on claims, borrowed money and other liabilities (continued):

The Company borrowed \$30,000 on December 2, 2003 from Sevier County Bank and repaid \$30,000 principal and \$379.72 interest on February 24, 2004. The Company borrowed \$50,000 on December 10, 2003 from Sevier County Bank and repaid \$50,000 principal and \$527.39 interest on February 18, 2004. The Company borrowed \$100,000 on December 29, 2003 from Citizens National Bank and repaid \$100,000 principal and the related interest on March 10, 2004.

The Company's Minutes of the meeting of the Board of Directors in 2003 and the loan agreements reflected the money borrowed by the Company was for the payment of losses. This was in accordance with Tenn. Code Ann. § 56-22-112 "No debts created except for the payment of losses". Tenn. Code Ann. § 56-22-112 states that "the officers of the corporation shall not enter into any contract or agreement or make any debt of any kind, except for the payment of losses".

The Company's Secretary / Treasurer, Bill Delozier stated that although the Company had ample surplus to pay all claim losses incurred in 2003 the Company chose to borrow the money. The Company decided that the cost of borrowing money to pay claims was less than the loss of interest and payment of penalty associated with the liquidation of certificates of deposit held by the Company at local financial institutions before the certificates of deposit matured.

Claims appear to be paid promptly and to the satisfaction of the policyholders.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business:

Market Conduct Violation

Beginning in 2001 the Company offered to policyholders at no cost a liability policy through Farmers Mutual of Tennessee of \$100,000 and a theft policy of \$10,000 on dwellings insured for \$80,000 or more.

For the aforementioned policies the Company's declaration page listed "Broad Theft Coverage" and "Farmers Mutual of Tennessee Liability" coverage for the insured without an amount for premiums.

However, Tenn. Code Ann. § 56-22-101(a) does not permit the Company to insure for liability exposure nor does it allow the Company to act as an agent on behalf of Farmers Mutual of Tennessee (Knoxville) for the issuance of a liability policy. Only a duly licensed agent in the State of Tennessee can issue a liability policy directly to a policyholder of the Company on behalf of Farmers Mutual of Tennessee (Knoxville). Also, a Tennessee licensed agent can not issue a policy on behalf of Farmers Mutual of Tennessee unless he has been appointed by said company.

Furthermore, the Company should completely disclose the policy terms on their policy forms for each type of coverage and the premium obligation of the policyholder including the theft coverage form.

The Company as of December 31, 2003 had approximately 102 policies in force that met the aforementioned criteria. The total amount of liability and theft premium for these policies that was not billed to the policyholders was \$8,126.00.

Prepaid Expenses Not-Admitted

The Company listed as an asset "prepaid insurance" in the amount of \$1,260 and "prepaid premium tax" in the amount of \$8,017 as an admitted asset under the caption "Other Assets" in the Assets Section – IV on the 2003 Annual Statement. The total of these two (2) prepaid expenses shown on the Annual Statement was \$9,277. This \$9,277 total for prepaid expenses will not be admitted for purposes of this examination in accordance with Tenn. Code Ann. § 56-1-405 "Assets Allowable as Credits". Tenn. Code Ann. § 56-1-405 does not allow the admittance of assets that are not available for the payment of losses.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (continued):

Reinsurance Ceded

The Company did not disclose on its 2003 Annual Statement the total amount of insurance in force ceded to its reinsurer, Farmers Mutual Insurance Company of Knoxville, Tennessee.

Likewise, the Company did not disclose on its 2003 Annual Statement the net amount of insurance in force after a deduction was made for the total amount of insurance in force ceded to the Company's reinsurer.

Subsequent to the December 31, 2003 date of examination, the Company on June 21, 2004 provided a \$12,363,375 amount of insurance in force as of December 31, 2003 ceded to its reinsurer, Farmers Mutual Insurance Company of Knoxville, Tennessee.

Claims Payable

The Company provided a reserve for claims of \$15,420 as of December 31, 2003. At December 31, 2003 the Company had four (4) pending claims including one contested claim.

The Company was a defendant in a lawsuit in which the plaintiffs were seeking the \$90,000 insured value of their home that was destroyed by fire in 2001. Under the provisions of the policy, the property was covered to the full amount of the policy contingent upon occupancy of the property. However, the policy only provides for a claim payment of half the insured value if the property was unoccupied at the time of insured loss. In 2002 the Company paid \$45,000 on the claim based upon the assertion that the property was unoccupied at the time of the fire. The Company's reinsurance agreements limited the Company's portion of the loss to \$50,000.

Concentration of Credit Risk

The Company maintained one (1) checking account, one savings account and sixteen (16) certificates of deposit totaling \$1,578,379.15. At December 31, 2003 the Company's deposit balances exceeded the Federal Deposit Insurance Corporation insured limits by approximately \$678,000.

Refunds Due on Premium Taxes

The Company as of the date of this examination report was due a premium tax refund of \$3,703 for the 2002 calendar year and \$4,828.30 for the 2003 calendar year. These refund amounts were based upon premium tax returns submitted to the Tennessee Department of Commerce and Insurance by the Company.

Policy Limits, Reinsurance and Retention Limits

Based on the Company's amount of total insurance in force, T.C.A. §56-22-106 sets the maximum amount of coverage the Company is permitted to write on any one risk or hazard subject to one fire or loss at the maximum amount of \$50,000. Policy coverage in excess of \$50,000 on any single risk was ceded to Farmers Mutual Insurance Company of Knoxville, Tennessee.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (continued):

Office Hours

The Company's Board of Directors in July of 2003 set the office hours from 8:00 AM to 4:00 PM, Monday through Friday. Previously the office hours were 8:00 AM to 4:00 PM, Monday, Tuesday, Thursday and Friday and 8:00 AM to 12:00 PM on Wednesday.

Statement of Accounting

This examination as of December 31, 2003 was conducted on an accrual basis as compared to cash basis accounting. The Company contracted with H G & A Associates, P. C. (Certified Public Accountants) to prepare their 2002 and 2003 Annual Statements on an accrual basis. Normally, the statement of assets, liabilities, income and expenses for Tennessee "County Mutual" Insurance Companies is presented on a cash basis.

Location of Books and Records

All of the Company's books and records were kept in its office building located at 144 West Main Street in Sevierville, Tennessee, 37862.

There were no apparent violations of the Company's By-Laws.

Recommendations:

It is recommended that the Company implement the following measures of corrective action for purposes of complying with statutory requirements:

- (1) The Company should cease from acting as an agent on behalf of Farmers Mutual of Tennessee (Knoxville) for the issuance of a liability policy in violation of Tenn. Code Ann. § 56-22-101(a). Only a duly licensed and appointed agent in the State of Tennessee can issue a liability policy directly to a policyholder of the Company on behalf of Farmers Mutual of Tennessee (Knoxville).
- (2) The Company should completely disclose the policy terms on their policy forms for each type of coverage and the premium obligation of the policyholder including the theft coverage form.
- (3) The Company should refrain from listing as an asset "prepaid insurance" and "prepaid premium tax" as an admitted asset under the caption "Other Assets" in the Assets Section – IV on the Annual Statement. Tenn. Code Ann. § 56-1-405 does not allow the admittance of assets that are not available for the payment of losses.

Conclusion

It was determined that, as of December 31, 2003, the Company had admitted assets of \$1,687,842 and liabilities of \$400,298. Thus, there existed for the additional protection of the policyholders, the amount of \$1,287,544 in the form of unassigned funds (surplus).

The complete and courteous cooperation of Mrs. Virginia Newman, Bookkeeper and Mr. Bill Delozier, Secretary / Treasurer, extended during the course of the examination is hereby acknowledged.

Respectfully submitted,

James T. Pearce, Jr.

James T. Pearce,
Insurance Examiner in Charge
State of Tennessee

Examination Affidavit:

The undersigned deposes and says that he has duly executed the attached examination report of The Farmers Mutual Fire Insurance Company of Sevier County, Tennessee dated November 23, 2004 and made as of December 31, 2003, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says he is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information and belief.

James T. Pearce, Jr.

James T. Pearce
Insurance Examiner
State of Tennessee

County
State

Davidson
Tennessee

Subscribed and sworn to before me

this 23rd day of
November, 2004.

Helen M. Lersey
(Notary)

FARMERS' MUTUAL INSURANCE COMPANY

144 West Main Street • Sevierville, TN 37862
(865) 453-2952

RECEIVED

Dept. of Commerce & Insurance
January 15, 2005

December 15, 2004

Mr. Don Spann, CFE
Insurance Examination Director
State of Tennessee
Department of Commerce & Insurance
500 James Robertson Parkway
Nashville, TN 37243

Dear Mr. Spann:

In reply to the corrective action you recommended on page 15 of report of examination of Farmers Mutual Fire Insurance Company of Sevier County, we have made the following corrections.

(Item 1) Mr. Gordo Watson of Farmers Mutual of Tennessee, Knoxville is taking care of the procedure on their part.

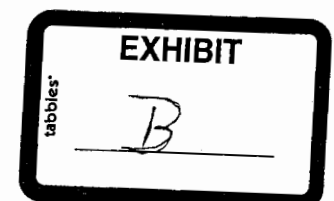
Listed is the information for the two agents in our office that writes liability:

Virginia L. Newman
1313 Dixon Branch Rd.
Sevierville, TN 37876
SSN # 415-94-4141
ID # 0000833158

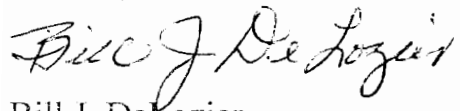
Bill J. DeLozier
221 S. Shiloh Rd.
Seymour, TN 37865
SSN # 411-50-4751
ID # 0000848933

(Item 2) We corrected that item when it was called to our attention. Each item on the declaration page is listed with the amount of coverage and the premium.

(Item 3) Ms. Melinda Ogle of HG & A Associates PC, PO Box 50846, Knoxville, TN 37950-0846, talked with Mr. James T. Pearce, Insurance examiner in charge about this matter, and it will be corrected on this years audit.



Thanks,

A handwritten signature in black ink, reading "Bill J. DeLozier". The signature is written in a cursive style with a large, stylized "B" and "D".

Bill J. DeLozier

Secretary-Treasurer of

Farmers Mutual Fire Insurance Company of Sevier County



Farmers Mutual of Tennessee

P. O. BOX 3428 903 NORTH FIFTH AVENUE KNOXVILLE, TENNESSEE 37927 (865) 523-5153

December 15, 2004

Mr. Bill Delozier
Farmers Mutual Fire Insurance Company
of Sevier County
144 W. Main St.
Sevierville TN 37662

Bill:

Farmers Mutual is in receipt of your and Virginia's Insurance Licenses. We checked our records and found that you were mistakenly left off our filing with the Department's licensing section. This was an oversight by our agent licensing department.

I am forwarding the appropriate paperwork to the Department in order to correct this oversight. I apologize for the mistake and will get it remedied immediately so we will all be in compliance with Tenn. Code Ann. 56-22-101(a).

Sincerely,

Gordo Watson
Farmers Mutual of Tennessee

cc Department of Commerce and Insurance
Agent Licensing Section